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No. 91-530

Supreme Court, U.S.
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IN THE
SUPREME COURT OF THE UNITED STATES

October Term, 1991

JAMES C. PLEDGER, COMMISSIONER
OF REVENUES, *Petitioner*

V.

ILLINOIS TOOL WORKS, INC.
Respondent

PETITION FOR A WRIT OF CERTIORARI
TO THE SUPREME COURT OF ARKANSAS

REPLY BRIEF FOR THE PETITIONER

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ARKANSAS LEGISLATIVE DIGEST, INC.

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Pursuant to this Court's Rule 15.6, petitioner, James C. Pledger, Commissioner of Revenues, Department of Finance and Administration, State of Arkansas, respectfully submits this Brief in Response to the Brief In Opposition ("Opposition") to its Petition for Writ of Certiorari ("Petition") that was filed by Illinois Tool Works, Inc. with respect to matters not addressed herein, petitioner relies on its Petition.

REPLY TO RESPONDENT'S BRIEF IN OPPOSITION

I.

RESPONDENT MISSTATES THE FACTS OF THIS CASE.

The facts are the facts, and those presented by the petitioner clearly reflect those found in the record below,

including the Findings of Fact and Conclusions of Law of the Chancellor (which were drafted by respondent's counsel as the prevailing party). However, a comparison of the Findings of Fact will show inconsistencies with the respondent's Statement of the Case.

Respondent emphasizes UDITPA and the regulations promulgated by the Multistate Tax Commission (MTC). These regulations have been referred to as "full apportionment" regulations. Although respondent asserts that these regulations were rejected in *ASARCO, Inc. v. Idaho State Tax Comm'n.*, 485 U.S. 307 (1982), *F.W. Woolworth Co. v. Dept. of Taxation*, 458 U.S. 354 (1982), and *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 (1983), petitioners posit that that is not the case. Further, the court in *Qualls v. Montgomery Ward*, 266 Ark. 207, 585 S.W.2d 18 (1979), found the intangible income was apportionable based upon the definition of "business income" as set forth in the Arkansas statutes, not as stated by respondent. The case must be read in its entirety and phrases cannot be abstracted to make the case stand for something which it does not stand for. The emphasis placed by respondent highlights the importance of this case to the administration of tax laws in Arkansas and other states which have adopted UDITPA and/or the MTC regulations.

Revenue Policy Statement 1984-2 (Pet. D-1—D-2) does not indicate that the Revenue Division refused to follow the standards concerning due process which have been enunciated by this Court. Does the position taken by the Revenue Division concerning the apportionment of intangible income other than dividends comport with the decisions of other state courts of last resort, which have held the income to be apportionable where the activities producing the income were

"integral parts of the taxpayer's regular trade or business"? Petitioner submits that the answer to this question is "yes".

Petitioner simply does not have the space to refute each misstatement made by respondent. However, respondent is totally off base on the issues raised by the petitioner in its appeal to the Supreme Court of Arkansas.[1]

Likewise, what did the Supreme Court of Arkansas declare unconstitutional when it held:

> Those holdings require us . . . to declare appellant's Regulation 1984-2 to be unconstitutional. ?

(Pet. A-7)

1984-2 is a policy statement, not a regulation. Respondent alleges that both the MTC regulation and the policy statement were declared unconstitutional.

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[1] POINTS ON APPEAL

I. THE CHANCELLOR ERRED BY HOLDING A UNITARY DETERMINATION WAS ESSENTIAL TO TAX INVESTMENT INCOME OF A SINGLE CORPORATE TAXPAYER; CHANCELLOR MISAPPLIED UNITARY BUSINESS ANALYSIS.
   - A. Uniform Allocation and Apportionment of Multistate Income Jeopardized
   - B. History of Unitary Apportionment
   - C. Modern Era of Unitary Taxation
   - D. *ASARCO* does not Shield Investment Income from State Taxation

II. ARKANSAS PROPERLY SUBJECTS INTANGIBLE INCOME TO TAXATION; INTERPRETATIVE REGULATION AND POLICY STATEMENT NOT INCOMPATIBLE WITH *ASARCO* AND *WOOLWORTH*.

III. THE CHANCELLOR ERRED BY DETERMINING CAPITAL GAINS PARTLY DERIVED FROM ARKANSAS INCOME NOT APPORTIONABLE BUSINESS INCOME UNDER *MONTGOMERY WARD*.

The respondent is emphasing "facts" which are not relevant to the decision of this Court to grant the Petition for a Writ of Certiorari.

II.

A CONFLICT BETWEEN COURTS OF LAST RESORT IS APPARENT.

There can be no doubt that there is a conflict with decisions of other courts of last resort on the issue of the due process standards to be used in determining whether a state can apportion the intangible income of a nondomiciliary corporation. At least three (3) Petitions for Writs of Certiorari have been filed in this Court on this very issue within the past few months. *Corning Glass Works, Inc. v. Virginia Dept. of Taxation*, 241 Va. 353, 402 S.E.2d 35 (1991), *cert. denied*, 60 U.S.L.W. ___ (U.S. Oct. 7, 1991) (No. 90-1852); *Bendix Corp. v. Director*, 125 N.J. 20, 592 A.2d 536 (1991), *petition for cert. filed*, (U.S. Oct. ___, 1991) (No. 91-___). As previously indicated, a number of cases are now pending in the courts of last resort of several states. Petitioner submits that the facts of these cases are not so readily distinguishable as respondent would have this Court believe.

The Supreme Court of Arkansas has not applied the correct unitary business principle to the facts of this case. There is not an exclusive test, such as the requirement that the income payor and recipient must have a unitary relationship, to be used in determining whether under the Due Process Clause, income can be apportioned.

Respondent failed to cite specific cases holding intangible income to be "business income" where the investments were short term. In fact, respondent apportioned its

income from certain of its short term investments. However, long-term investments may be indicative of a unitary business relationship, and the longer the holding period the more likely that the asset is utilized or related to the operation of the business.

Respondent has also indicated that cases in which intangible income was found to constitute "business income"

> presented factual situations where the corporate taxpayer's activities incident to the acquisition, management and disposition of the capital assets were found to have been an integral part of the corporate taxpayer's regular trade or business.

(Br. Opp. 14)

This is the very standard that the Arkansas Supreme Court refused to apply in this case. It was also the standard in *Montgomery Ward, supra*, which the Arkansas Supreme Court overruled.

Respondent has misconstrued the holdings of the Missouri Supreme Court in *James v. International Tel. & Tel. Corp.*, 654 S.W.2d 865 (Mo. 1983), *Philip Morris, Inc. v. Director*, 760 S.W.2d 888 (Mo. 1988) and *Williams Cos. v. Director*, 799 S.W.2d 602 (Mo. 1990), *cert. denied*, ___ U.S. ___ , 115 L.Ed.2d 1079 (1991).

A concession of an issue, such as the preferred stock issue, does not mean that there is an admission that the income or loss was "nonbusiness income or loss". Here the net result of the concession was a loss and resulted in a larger tax assessment.

Respondent's argument that no conflict exists must fail

upon a reading of the cases cited in the Petition filed herein.

III.

RESPONDENT DOES NOT ADDRESS THE NATIONAL IMPORTANCE OF THIS CASE OR THE FACT THAT THIS IS A SINGLE CORPORATE TAXPAYER.

Respondent has not addressed the issues raised by petitioner. Illinois Tool Works is a single corporate taxpayer. A division was located in Pine Bluff and certain items were leased to bottling companies in Arkansas by the Hi-Cone division. This Court has not considered whether the unitary business principle payor/payee tests are applicable to single corporate entities. Illinois Tool Works is clearly a unitary business. The Court in *Silent Hoist & Crane Co. v. Director*, 100 N.J. 1, 494 A.2d 775, *cert. denied*, 474 U.S. 995 (1985), found that the dividend payor and dividend recipient test found in *Mobil, Exxon, ASARCO, Woolworth* and *Container* was not applicable. Respondent and the Supreme Court of Arkansas erroneously apply the unitary business principle to this case. This question needs to be addressed by this Court.

Can a corporation have acquisition and investing as a part of its regular business activity? Yes. The Supreme Court of Arkansas uses blinders in its review of prior decisions of this Court. For instance, it quotes *Mobil* and focuses on "in the course of activities unrelated to the sale of petroleum products in that state." (Pet. A-5) It is difficult for many to see how acquisition and investment income can be business income. Perhaps this is because the primary tax considerations usually revolve around federal taxation, as opposed to state tax matters. To most, capital gains result from unearned income hence the concept that capital gains are usually perceived to be

"nonbusiness income". However, when viewed in a federal corporate tax setting, as opposed to an individual tax setting, intangible income, including income from capital gains, is taxed as ordinary income.

A federal question is presented here. Respondent's argument is spurious. The questions raised in the Petition are genuine and this case should be heard so that taxpayers and states can determine with certainty the proper standards to apply in determining the apportionability of intangible income. This Court's guidance in this area is sorely needed.

CONCLUSION

For the foregoing reasons, the Petition for a Writ of Certiorari should be granted.

Respectfully submitted,

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